

CORONADO OIL CO.

IBLA 79-149

Decided August 22, 1979

Appeal from a decision of the Wyoming State Office, Bureau of Land Management, holding lease W 15891 to have expired for failure to pay annual rental on or before the lease anniversary date.

Hearing ordered.

1. Administrative Procedure: Hearings – Hearings – Oil and Gas Leases: Extensions – Oil and Gas Leases: Termination – Oil and Gas Leases: Well Capable of Production – Rules of Practice: Hearings

A hearing is properly ordered where there exist issues of fact the resolution of which will determine whether an oil and gas lease concluding its primary term was converted from rental status to royalty status. Appellant shall have the burden of proof to establish by a preponderance of the evidence (a) that the Dolezal-Government #1 well was capable of producing oil and gas in paying quantities on October 31, 1978, or (b) that there was a discovery of oil or gas in paying quantities on lease W 15891 on October 31, 1978. If either (or both) of these propositions is established, the subject lease was not subject to automatic termination by law for failure to make timely rental payment.

APPEARANCES: Roscoe Walker, Jr., Esq., Gorsuch, Kirgis, Campbell, Walker and Grover, Denver, Colorado, for appellant.

OPINION BY ADMINISTRATIVE JUDGE HENRIQUES

Coronado Oil Co. has appealed from a decision of the Wyoming State Office, Bureau of Land Management (BLM), dated December 15, 1978, which held that oil and gas lease W 15891 had expired at the end of its primary term, October 31, 1978. The basis for this decision was Coronado's failure to pay annual rent on or before November 1, 1978, the lease anniversary date, at which time an anticipated 2-year extension of the primary term was to begin. This extension is authorized by 43 CFR 3107.2 for a lease on which actual drilling operations were commenced prior to the end of its primary term and are being diligently prosecuted at that time. BLM found that Coronado's failure to make a timely rental payment resulted in automatic termination by operation by law.

In its statement of reasons on appeal, Coronado makes three arguments:

1. The above captioned lease is not subject to automatic termination by operation of law for the reason that prior to November 1, 1978 and at all times thereafter there was and has been a well on said lease capable of producing oil or gas in paying quantities.
2. A "discovery" of gas in paying quantities was made on the subject lease prior to November 1, 1978 and by reason thereof this lease did not automatically terminate but was converted from a rental status to a royalty status.
3. Alternatively even if commercial production had not been obtained prior to the end of the primary term, which Coronado has amply demonstrated is not the case, nevertheless Coronado is entitled to a two-year extension of its lease pursuant to 30 U.S.C. § 226(e) (1976) and 43 C.F.R. § 3107.2 for the reason that drilling operations were being diligently conducted thereon over its expiration date.

Appellant's first argument on appeal is directed to 30 U.S.C. § 188(b) (1976) which states in part:

Notwithstanding the provisions of this section, however, upon failure of a lessee to pay rental on or before the anniversary date of the lease, for any lease on which there is no well capable of producing oil or gas in paying quantities, the lease shall automatically terminate by operation of law

This provision is echoed in 43 CFR 3108.2-1, the Department's regulation implementing the above code section:

(a) Automatic terminations. Except as provided in paragraph (b) of this section, any lease subject to the provisions of section 31 of the Act, as amended by section 1(7) of the Act of July 29, 1954 (30 U.S.C. 188) on which there is no well capable of producing oil or gas in paying quantities, shall automatically terminate by operation of law if the lessee fails to pay the rental on or before the anniversary date of such lease.

Appellant has furnished this Board with considerable evidence of its operations shortly prior to the critical anniversary date.

In support of the argument that there was on the lease a well capable of producing oil or gas in paying quantities on October 31, 1978, appellant offers the following data. The Dolezal-Gov't. #1 well in the NE 1/4 SW 1/4, sec. 17, T. 45 N., R. 96 W., sixth principal meridian, the well in question, was spudded on July 27, 1978, and drilled to a total depth of 10,456 feet. Thereafter, new 5-1/2 inch O.D.-15-1/2 pound production casing was run to a depth of 8,398 feet. Perforation and testing of individual zones was commenced on October 11, proceeding upward from the bottom of the hole. On October 20, the 4th Frontier Sand (4a) was tested through perforations between depths of 7,000 and 7,012 feet. Thereafter on October 21, the well was acidized and for a period of 8 hours flowed gas with water at the rate of 25 mcf/gpd. That zone was then plugged by a drillable bridge above the perforations. On October 24, the casing was perforated between 6,936 and 6,960 feet in the 3rd Frontier Sand. Flammable gas, condensate, and fresh water flowed for 12 hours at the rate of 30 mcf/gpd. A drillable bridge was set above these perforations. Coronado at that time determined it had made an economic discovery. On October 31, the casing was perforated from 6,760 through 6,824 feet in the Upper Frontier Sands (1a and 1b). Without treatment, gas with fresh water flowed at the rate of 60 mcf/gpd.

It is appellant's position that on October 31, 1978, the Dolezal-Gov't. #1 well had a cumulative gas flow of 115 mcf/gpd, which was extrapolated to show a potential net profit of more than \$3,600 per month. On the basis of this calculation and the fact that the Dolezal-Gov't. #1 had been cased, perforated, and tested in three horizons prior to November 1, 1978, from each of which gas flowed in amounts claimed to be sufficient to constitute an economic discovery, Coronado argues that the Dolezal-Gov't. #1 was a well capable of producing gas in paying quantities on October 31, 1978.

Appellants' second argument on appeal, *i.e.*, that a discovery of gas was made on the subject lease prior to November 1, 1978, is based upon 30 U.S.C. § 226(d) (1976) which states in part: "A minimum royalty of \$1 per acre in lieu of rental shall be payable at the expiration of each lease year beginning on or after a discovery of oil or gas in paying quantities on the lands leased." In support of its

argument that a discovery was made on the subject lease prior to November 1, 1978, Coronado offers much the same data as set forth above in support of its first argument on appeal.

The Government disputes the conclusions reached by Coronado and maintains instead that the well testing information available to the Thermopolis District Oil and Gas Engineer, U.S. Geological Survey (GS), was too indefinite to determine whether this well would prove to be a gas well or a water production well contaminated with an indefinite amount of flammable gas.

[1] A factual dispute of this nature should properly be resolved at a hearing. Universal Resources Corp., 31 IBLA 61 (1977); Manhattan Resources, Inc., 34 IBLA 346 (1978). Accordingly, we vacate the decision of BLM, dated December 15, 1978, and refer this matter to the Hearings Division, Office of Hearings and Appeals, for hearing before an Administrative Law Judge on the following two issues:

1. As of October 31, 1978, was the Dolezal-Gov't. #1 well capable of producing oil or gas in paying quantities?
2. As of October 31, 1978, was there a discovery of oil or gas in paying quantities on lease W 15891?

If either question (or both) is resolved in the affirmative, lease W 15891 converted from rental status to royalty status, and therefore termination by operation of law did not occur as set forth in BLM's decision of December 15, 1978. At the hearing, Coronado shall have the burden of proof to establish by a preponderance of the evidence the affirmative of either question (or both).

Appellant argued that its diligent drilling operations over the expiration date of the lease entitled it to a 2-year extension of the lease pursuant to 30 U.S.C. § 226(e) (1976). We agree that appellant was entitled to such a 2-year extension by virtue of its operations at the conclusion of the primary term of the lease. The argument of appellant that rental for the extended eleventh year of the lease should be payable only after it has been notified that the lease qualifies for an extension because of drilling operations has been considered by the Board in Oil Resources, Inc., 28 IBLA 394, 84 I.D. 91 (1977). There it was held that a lessee was required to pay rental on or before the anniversary date of the lease for the first year of its anticipated extended term. As the rental payment was not made timely, the lease terminated automatically by operation of law, 30 U.S.C. § 188(b) (1976), and unless the lessee could show entitlement to reinstatement under 30 U.S.C. § 188(c) (1976), no extension of the lease under 30 U.S.C. § 226(e) (1976) could be obtained. If then pertinent to disposition of this appeal, the question of reinstatement of the lease will be addressed after resolution of the issues to be heard by the Administrative Law Judge.

Following the hearing, the Administrative Law Judge shall prepare a recommended decision and serve it on both parties, Coronado and U.S. Geological Survey, allowing a period of 30 days from receipt thereof for each to submit a brief thereon to this Board with service also on the opposing party. Answering briefs may thereafter be submitted to the Board within an additional 30 days of receipt of initial brief.

Accordingly, pursuant to authority delegated to the Board of Land Appeals by the Secretary of the Interior, 43 CFR 4.1, the case is referred to the Hearings Division for assignment to an Administrative Law Judge for conduct of the required hearing.

Douglas E. Henriques
Administrative Judge

We concur:

James L. Burski
Administrative Judge

Newton Frishberg
Chief Administrative Judge

